

## **SAN LUIS OBISPO COUNTY FUNDS-MANAGEMENT AND FINANCIAL-AUDITING PRACTICES**

The Grand Jury reviewed the financial auditing and funds management practices of San Luis Obispo County Government (County) to assess their adequacies. The inquiry was county wide, but special attention was directed to the relevant practices of the Department of Social Services (DSS) because of the 2003 embezzlement charges against two of its employees. Since the time of the alleged fraud, DSS made several organization and management changes geared toward deterring fraud. According to the independent auditor's report for the year ended June 30, 2003, which is the only year covered by this inquiry, the County's financial audit meets generally accepted standards. Furthermore, the Grand Jury finds that the County's funds management practices meet generally accepted standards for private-sector companies.

### **Origin of the Inquiry**

The Grand Jury initiated this study of the County's funds management and financial auditing practices at their own initiative motivated by concerns raised by previous Grand Juries about the County's financial auditing practices, embezzlement charges filed in April 2003 against two DSS employees, and a citizen's complaint that alleged inadequate financial auditing and inattention to reducing the risk of fraud.

### **Authorization/Jurisdiction for the Inquiry**

§925. The grand jury shall investigate and report on the operations, accounts, and records of the officers, departments, or functions of the county including those operations, accounts, and records of any special legislative district or other district in the county created pursuant to state law for which the officers of the county are serving in their ex officio capacity as officers of the districts. The investigations may be conducted on some selective basis each year, but the grand jury shall not duplicate any examination of financial statements which has been performed by or for the board of supervisors pursuant to Section 25250 of the Government Code; this provision shall not be construed to limit the power of

the grand jury to investigate and report on the operations, accounts, and records of the officers, departments, or functions of the county.

§925 (a). The grand jury may at any time examine the books and records of any incorporated city or joint powers agency located in the county. In addition to any other investigatory powers granted by this chapter, the grand jury may investigate and report upon the operations, accounts, and records of the officers, departments, functions, and the method or system of performing the duties of any such city or joint powers agency and make such recommendations as it may deem proper and fit. The grand jury may investigate and report upon the needs of all joint powers agencies in the county, including the abolition or creation of agencies and the equipment for, or the method or system of performing the duties of, the several agencies. It shall cause a copy of any such report to be transmitted to the governing body of any affected agency.

### **Method**

The Grand Jury interviewed selected county officials and reviewed county documents. Additionally we looked for similarities and differences between the contractual scope-of-services for the independent financial audits for San Luis Obispo (SLO) County and Santa Barbara County. We chose Santa Barbara County for this comparison because it is a close neighbor to SLO County and because its population is similar. If material differences were found, we intended to make comparisons with other counties, but for reasons discussed below that was not necessary. We also reviewed the independent auditor's reports for several California county governments searching for similarities and differences between them and the one for SLO County.

The Grand Jury interviewed the County Auditor-Controller, the Administrative Manager of DSS, and a Senior Division Manager of DSS.

Documents and forms reviewed included:

- Contracts for the performance of annual audit for SLO County and for Santa Barbara County.
- Independent auditors' reports for SLO County and for several other California county governments.
- DSS procedures for authorization of services, purchases, and other outlays.
- Forms for participant expense authorization, for vendor authorization to deliver articles and/or services, and for special order requisition of office supplies.
- Reports of cash shortage and of unannounced cash count audits.
- Reports of review of imprest cash accounts (an advance or loan of government or public funds toward performance of some service for the government).
- Code of Ethics, Conflict of Interest, and Gift Policy for DSS.
- Procedures for Handling Confidential Cases in Participant Services Division of DSS.
- Organizational charts of relevant SLO County organizations.

### **Narrative**

Each year, the County has a financial audit conducted by an independent auditing firm that covers all departments of the county government. The Grand Jury did not examine the county's financial statements because California Penal Code §925 states: "the grand jury does not have the authority to duplicate any examination of financial statements that have been performed by or for the Board of Supervisors". Therefore, the Grand Jury limited its inquiry of financial audits to a review of the terms and conditions of the most recent contract for the annual financial audit, which covers the fiscal years 2002-03 through 2005-06, and the auditor's report for the fiscal year ended June 30, 2003.

The scope of services for the annual financial audit for the years stated above is extracted from the contract with the independent auditor. The principal services provided were:

- "Contractor will conduct audits of the financial statements of the county in accordance with generally accepted auditing standards for the purpose of expressing

an opinion on the conformity of the financial statements with generally accepted accounting principles.”

- “Contractor shall review internal controls of county accounting systems and procedures ... as required by generally accepted auditing standards and issue a written management report based on the review.”
- “Contractor shall review a majority of federal funds and grants received by the county for compliance with federal regulations.”

Bartig, Basler & Ray performed the county’s financial audit for the year ending June 30, 2003. Excerpts taken from the auditor’s report express their opinion on the financial statements reviewed.

- “We conducted our audit in accordance with auditing standards generally accepted in the United States of America and standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.”
- “In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the government activities, the business-type activities, each major fund, and aggregate remaining fund information of the County of San Luis Obispo, California, as of June 30, 2003, and the respective changes in financial position and cash flows, where applicable, for the year then ended, in conformity with auditing principles generally accepted in the United States of America.”

The Grand Jury also reviewed the contract County of Santa Barbara executed with an independent auditing firm to perform an audit of its financial statements for the fiscal year

ended June 30, 2003. As far as we can determine, the scope of service for Santa Barbara County Government is in all material aspects similar to that performed under contract for SLO County. Additionally, we reviewed independent auditor's reports for several California county governments and compared the depth of services performed for those counties with that for SLO County. We concluded that the depth of services for all the county audits we reviewed were similar in all material aspects.

These comparisons do not confirm that the County's financial audits are similar in scope to those performed for all other California counties, but it does provide a degree of confidence that the scope of the County's financial audit is not unique among California counties.

The financial audits performed for SLO County, as well as those performed for the other California counties we considered, are not full audits. That is, every financial transaction is not reviewed for proper accounting, recording and authorization. As noted above, however, the County's annual financial audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. While financial audits for private-sector companies vary widely in scope, the norm for private companies' financial audits is not materially different than those performed for the County.

The external auditor for the County's annual financial audit does not examine individual purchase and reimbursement requests to determine compliance to the county's authorization procedures. County employees are responsible for ensuring valid authorization.

County employees check every financial transaction prior to making payment for evidence to support the amount of the purchase or reimbursement request and to ensure proper authorization, compliance to county regulations, and proof of delivery.

On a regular basis, the Auditor-Controller Office conducts unannounced cash count audits, review cash handling procedures, and review imprest cash accounts. The Grand Jury reviewed many of these recent audits and found no cause for concern.

The Grand Jury also reviewed the County's authorization process for purchases and reimbursements. Depending on the amount of purchase or reimbursement, one or more levels of supervision must approve every request. Based on Grand Jurors' personal experiences while working for private companies, the authorization limits for County supervisors and managers is quite conservative compared to those for private companies.

Since Spring 2003 when two of its employees were charged with embezzlement, the DSS has made several changes in its organization structure, management practices, and work assignment procedures that are geared to reduce the risk of fraud. These changes include:

- Welfare applicants are received by clerical/reception employees who assign cases on a rotation basis using an automated system to ensure equitable caseload distributions as well as preventing staff from assigning applicants to themselves.
- Moved away from specialized units that cover only a single type of casework to units that cover multiple types of casework. Every staff person in a unit supports multiple programs. Supervisors have the responsibility for all programs in that unit.
- Staff, supervisors, and managers rotate frequently into new job assignments. This provides opportunities for checks and balances.
- On a weekly basis, each supervisor receives a log containing vital information for new welfare applicants and on a monthly basis for continuing cases. Supervisors review these logs with appropriate caseworkers.
- Other supervisor duties that provide opportunities to detect fraudulent activities include:
  - They randomly select cases for review each month for each caseworker.
  - They attend case staffing meetings where specific cases are discussed.
  - They work uncovered caseloads when a caseworker is sick or otherwise unavailable. This provides opportunity to review cases, handle incoming mail, and have direct contact with clients.
  - They fill in for other supervisors and managers on leave or otherwise not available to perform their duties.

Checks and balances such as those implemented by DSS deter fraud. However, no system of checks and balances can prevent fraud in an organization as diverse as the County in general or DSS in particular. Only time will tell whether or not the new system meets its objective for fraud deterrence. The steps taken by DSS, however, seem to be in the right direction.

### **Conclusion**

- An external accounting firm performs the annual financial audit for SLO County. The audit covers every department. For the most recent financial audit, the auditors found "...the financial statements...present fairly, in all material respects...the financial position of the County of San Luis Obispo, California, as of June 30, 2003, and the respective changes in financial positions and cash flows, where applicable, for the year then ended, in conformity with accounting principles generally accepted in the United States of America." The Grand Jury neither agrees nor disagrees with this professional opinion of the independent auditor; a Grand Jury position other than that of the independent auditor would have required a duplicate examination of the financial statements, which is prohibited by California Penal Code § 925.
- So far as the Grand Jury can determine, the contractual scope-of-services for the annual audit performed for SLO County is in all material aspects similar to that performed for Santa Barbara County, and the depths of audits for California counties do not differ significantly from the audit performed for SLO County.
- SLO County's cash handling procedures and audits of compliance to these procedures are consistent with procedures used by private-sector companies.
- SLO County's procedures for authorizing expenditures and approving payments and reimbursements are in all material aspects similar to those employed by private-sector companies.

- To reduce the risk of fraud, since Spring 2003 when two of its employees were charged with embezzlement, DSS made changes in its organization structure, management practices and work assignment procedures. These steps seem to be in the right direction.

### **Required Responses**

This is an informational report. A formal response is not required.